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No. 84-167

IN THE

Supreme Court of the United States

October Term, 1984

THE FIRESTONE TIRE & RUBBER COMPANY,
Appellant,

v.

FRANCHISE TAX BOARD,
Appellee.

On Appeal from the Court of Appeal of the
State of California
For the Second Appellate District

MOTION TO DISMISS OR AFFIRM

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APPELLEE'S STATEMENT OF QUESTIONS PRESENTED

1. Was the Due Process or Commerce Clause violated by the standard three-factor formula because (a) the difference between separate accounting and formula apportionment here is greater than said difference in *Container Corporation of America v. Franchise Tax Board* ____ U.S. ____ [77 L.Ed.2d 545] or (b) the lower courts refused to make adjustments to the property or wage factors as requested by Firestone, where Firestone failed to carry its burden of proof (with credible, admissible evidence of the need for such adjustments).

2. Did this Court in *Container* restrict the scope of *State* Appellate Court review of a ruling by a state trial court on a unitary question, to a determination whether the trial court ruling was "within the realm of permissible judgment."

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The Appellee, Franchise Tax Board (hereinafter "FTB") moves the Court to dismiss the appeal herein, or, in the alternative, to affirm the judgment below under Rule 16.1 on the ground that Firestone fails to present properly any substantial federal question. The questions raised have been fully resolved by prior decisions of this Court and/or rest on adequate nonfederal basis.

Appellant's first claim of formula distortion raises no substantial federal question. Firestone's tax returns cannot be used to indicate "distortion" because they indisputably understated the California tax measure. *Butler Bros. v. McColgan* [(1942) 315 U.S. 501, affmg. 17 Cal.2d 664] specifically approved a substantially greater adjustment than

the 56% increase complained of here. The wage adjustments sought by Firestone here are substantially identical with those rejected by this Court in *Container*. The property adjustments sought here were rejected by state courts because of Firestone's failure to carry its burdens of proof by credible admissible evidence. There are no substantial Due Process or Commerce Clause issues which this Court should consider.

Contrary to Firestone's second contention *Container* did not create a rule of scope of review which must be used by a state appellate court in reviewing state trial court rulings.

SUMMARY OF MATERIAL FACTS

The Jurisdictional Statement generally sets forth accurately the "Opinions Below," "Jurisdiction," and "Constitutional, Statutory and Regulatory Provisions" (JS, 2-4). However, it fails to disclose that two contentions which Firestone tries to raise here (requests for adjustment of wage factor and Ravenna property) were not raised in the Petition for Hearing in the California Supreme Court, or that both California courts ruled against Firestone's requests for modification of the formula because of its failure to carry its burden of proof by producing sufficient admissible credible substantiating evidence.

The California Court of Appeal ruled that Firestone engaged in a unitary business with its foreign subsidiaries and that Firestone failed to establish by competent evidence any ground for modifying the standard three-factor formula used by FTB. It applied the normal California rules of appellate procedure applicable to cases of this kind. (See *Anaconda Co. v. Franchise Tax Board* (1982) 130 Cal.App.3d 15, 23, *appeal dism.* 77 L.Ed.2d 1404.) The facts which it considered material are set out in its opinion. (JS, App. B.) Specific facts material here appear in the "Argument," *infra*.

ARGUMENT

I

FIRESTONE HAS NOT ESTABLISHED ANY SUBSTANTIAL FEDERAL BASIS FOR ITS ASSERTION THAT THE STANDARD THREE FACTOR FORMULA USED HERE VIOLATED THE DUE PROCESS OR COMMERCE CLAUSE

Firestone recognizes it had the "burden of showing by clear cogent evidence the [formula used here] results in extraterritorial values being taxed. (*Container Corp. v. Franchise Tax Board* 771 L.Ed.2d at p. 552." (JS 11.) The three-factor formula generally used will be sustained unless Firestone proved an unreasonable and arbitrary application. (JS 12.) Firestone claims to have sustained its burden because (it says) (1) certain leased Liberian property was improperly excluded from the property factor denominator (JS 13-17); (2) wage differences require use of "comparative wage differentials;" (JS 17-20); (3) there is "distortion" four times that approved in *Container* (JS 20-22); and (4) additions should have been made to factors for property, payroll and sales of its domestic subsidiary Ravenna Arsenal ("Ravenna"). (JS 24-25.) These arguments do not properly present any substantial federal issue to this Court.

A. Firestone Failed to Prove Improper Valuation of Liberian or Ravenna Property in the Property Factor

The California trial court found:

> "The Competent and admissible evidence before the Court does not establish any error in FTB figures used for the property factor with respect to the Liberia plantations or in regard to the FTB figures used for any of the factors with respect to the Ravenna Arsenal, Inc." (JS, appen. 33.)

This factual determination was affirmed. (JS appen. 14, 15, 16.)

Here, Firestone asks this Court to accept and require use of hearsay valuation testimony of a non-expert witness who has been impeached by

Firestone's own documents[1] even though such evidence has been twice rejected by California courts under California rules of evidence. Firestone simply failed to prove that any Liberian or Ravenna property used as part of its unitary business was improperly valued in the formula. The issues were questions of admissibility and weight of evidence, not questions for this Court. (*Grayson v. Harris* (1925) 267 U.S. 352, 358.)

B. Firestone Failed to Carry Its Burden of Establishing By Clear and Convincing Evidence a Need to Adjust the Wage Factor

Both California courts determined that Firestone failed to carry its burden to establish the need for adjustment to the wage factor. Firestone relied primarily on testimony of the same expert (Professor McDonald) who testified to substantially the same facts as were before this Court in the *Container* case. In his testimony Professor McDonald conceded that foreign subsidiary "return on investment" failed to reflect contributions by the Firestone United States parent to the profitability of the foreign subsidiaries; he conceded differences in productivity between American and foreign workers. Firestone has not presented evidence comparing employees in the United States with foreign subsidiary employees who are performing the same acts under the same circumstances; on the contrary, Firestone attempts to compare wages of Nigerian plantation workers with industrial employees in the United States.

This Court's *Container* decision established that Professor McDonald's testimony regarding differences in wage rates fails to establish a need to modify the wage factor. (*Container, supra*, 77 L.Ed.2d at 564.) Firestone's evidence fails to show comparable activities or productivity of the labor it tries to compare. Its wage comparison "evidence" falls far short of establishing any need to modify the standard three factor formula, let alone that modification would more

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[1] For example, contrary to "facts" in the Jurisdictional Statement based on hearsay testimony of Brandenberg (JS 8, 15) concerning Liberia, Firestone's own document showed that (1) only 90,000 (of a million) acres of leased land was used in the unitary business for rubber production (Exh. 950, pp. 3, 10), and (2) Firestone bought raw rubber from over 2,000 independent Liberian producers (Exh. 950, p. 17).

accurately apportion income. Firestone's wage factor arguments create no substantial federal question.[2]

C. The Difference in California Tax Measure on Firestone's Tax Returns and Under Formula Apportionment Does Not Support Review by This Court

Firestone's tax returns (which totally excluded all of its foreign subsidiary operations) attributed to California about 3.73% of its worldwide unitary income. California's standard three-factor formula attributed about 5.8% to California. Firestone calls this difference "distortion" which "quadruples" that "found acceptable" in *Container*. (*Container* did not find any "distortion" but merely compared the percentage difference to *Hans Rees* (77 L.Ed.2d at p. 565). Such facts do not create any substantial federal question for several reasons.

Firestone's returns were unquestionably incorrect; they cannot be used as a benchmark for measuring "distortion." Many changes were made by Franchise Tax Board which were never contested by Firestone; other adjustments have been finally upheld in the administrative or state court proceedings and are not being contested in the present appeal (*e.g.*, inclusion of Firestone's foreign natural rubber procuring and tire sales subsidiaries and various domestic activities which Firestone originally excluded from its unitary business). Any comparison to this figure is *totally meaningless*.

Firestone has failed to show that it has included in its separately accounted for U.S. income (or deducted from the foreign subsidiary income) any amounts which adequately compensated the U.S. parent for the extensive financial (guarantees and direct loans), technical, trademark and copyright (see Technical Service Agreements in evidence), and management (admitted by Prof. McDonald) assistance provided to the foreign subsidiaries. Firestone's California income per its return

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[2] Firestone's wage differential and Ravenna factor arguments were not included in the questions presented to the California Supreme Court. (Pet. for Hrg., 4-6.) Issues not properly raised before the highest state court may not be raised here. (28 U.S.C. 1257; *N.A.A.C.P. v. Alabama* (1957) 357 U.S. 449, 466.)

based on separate accounting for international subsidiaries (see JS 20, table V) is simply understated and cannot show the formula is not reasonable.

Also a percentage difference between separate accounting and formula tax measures does not show distortion by itself. An infinite percentage increase was upheld by this Court in *Butler Bros. v. McColgan* [(1942) 315 U.S. 495], while the 250% difference involved in *Hans Rees' Sons v. North Carolina* [(1931) 283 U.S. 123] was invalidated.[3]

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[3] When, as in *Butler Bros.*, separate accounting shows a net loss in California, the apportionment of any net income to California results in an *infinite* percentage increase. (In the *Butler Bros.* case, if there had been only $1 net income from California by separate accounting (rather than a loss), the formula would have increased the California tax measure over *9 million percent*.) *Butler Bros.* shows that no percentage of increase establishes by itself that there is unconstitutional "distortion."

Petitioners have cited *Hans Rees* (283 U.S. 123) as an example of unconstitutional distortion. However, there are several important differneces between *Hans Rees* and the instant case which are pointed out by the Supreme Court in *Container*. (77 L.Ed.2d at 564.)

First, in *Hans Rees*, the formula consisted of only *one factor*, based on the location of owned tangible property. The standard formula used by FTB in this case consists of an average of property, payroll and sales factors. Thus, the three factors serve to balance each other. (77 L.Ed.2d at 564-565.)

Second, in *Hans Rees* the court referred to a separate accounting analysis "purposely skewed to resolve all doubts in favor of" North Carolina. (*Ibid.*) Here Firestone's separate accounting of foreign subsidiaries is not "skewed" at all in favor of California. Rather, it appears to omit any payment to USA for substantial benefits from the U.S. parent corporation to the foreign subsidiaries (*e.g.*, guarantees of loans, management supervision). Additionally, Firestone has completely failed to present evidence the full value of other contributions to the foreign subsidiaries -- technical advice, trademarks, patents, training provided under the Technical Service Agreements -- was either paid to or reported as U.S. income of the U.S. parent. Thus, Firestone's separate accounting is "skewed" to underreport U.S. income and overreport foreign subsidiary net income.

Third, in *Hans Rees*, separate accounting attributed no more than 21.7% of the corporation's income to North Carolina. North Carolina's property-only formula attributed 66-85% of the total unitary income to North Carolina. (It obviously failed to reflect the substantial contribution of sales and payroll in

(Footnote 3 continued on page 7)

Firestone has failed to present any substantial admissible credible evidence of distortion. The California courts quite properly found under California rules of evidence that Firestone failed to carry its burden of proof of any ultimate facts indicating that California's tax measure approaches (let alone exceeds) the limits Constitutionally set by the decisions of this Court. Firestone has not properly presented any substantial "federal" question deserving to be considered by the U.S. Supreme Court.

II

FIRESTONE'S STANDARD OF REVIEW ARGUMENT DOES NOT JUSTIFY A HEARING

The California Court of Appeal applied the proper California standard of review in reversing the determination that certain foreign manufacturing subsidiaries were not unitary.[4]

(Footnote 3 continued)

other states to earning that unitary income.) (See 77 L.Ed.2d 564.) This change from separate accounting to formula apportionment resulted in a shift of almost 60% of the total unitary income without to within North Carolina. In the instant case Firestone's separate accounting (which overstates the amount earned by the foreign subsidiaries) attributes about .0372 of Firestone's worldwide unitary income to California, while California's three-factor formula apportions .0579 to California, a shift of only .0207 of the unitary income. (These figures are calculated from those in Firestone's Petition for Hearing in the California Supreme Court, pp. 12, 23.) These figures are not even remotely comparable to those in *Hans Rees*. This shift does not establish impropriety of the FTB formula. It is clearly "within the substantial margin of error inherent in any method of attributing income among the components of a unitary business." (77 L.Ed.2d 565.)

[4] *Anaconda Co. v. Franchise Tax Board* [(1982) 130 Cal.App.3d 15, *appeal dism.* 77 L.Ed.2d 1404], states the scope of review properly applied by the Court of Appeal in this case as follows:

> "Extensive testimony and voluminous documentary exhibits were received in evidence, but the essential facts of the case are

(Footnote 4 continued on page 8)

Firestone mis-cites this Court's decision in *Container*. The U.S. Supreme Court did not, as Firestone suggests, limit review by state appellate courts to a question whether the state trial court applied correct standards and its decision was within the realm of permissible judgment. This Court stated it would not look behind the state Court of Appeal determination of unity if the decision of the state Court of Appeal applied the correct standards and was "within the realm of permissible judgment." (*Container, supra*, 77 L.Ed.2d at 560.) This Court has approved California's of review by dismissing an appeal in which it was applied for want of substantial federal question. (*Anaconda Co. v. Franchise Tax Board* (1982) 130 Cal.App.3d 15, 23, *appeal dism.* 77 L.Ed.2d 1404.)

(Footnote 4 continued)

> undisputed. Since the issues here involve the application of taxing statutes to uncontradicted facts, this court is confronted purely with a question of law and is not bound by the findings of the trial court." (*Anaconda* at p. 23.)

Firestone does not dispute the correctness of the uncontradicted facts from its own records which the Court of Appeal found to be overwhelming evidence of unity. (JS appen. 20-24.) Nor does Firestone suggest that the California Court of Appeal did not use the "correct standards" of determining whether the business was unitary.

CONCLUSION

Firestone has raised no substantial federal question which justifies the attention of this Court. The California courts made factual determinations consistent with and correctly applied the law set out in the decisions of the U.S. Supreme Court.

The appeal should be dismissed or affirmed.

Respectfully submitted,

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